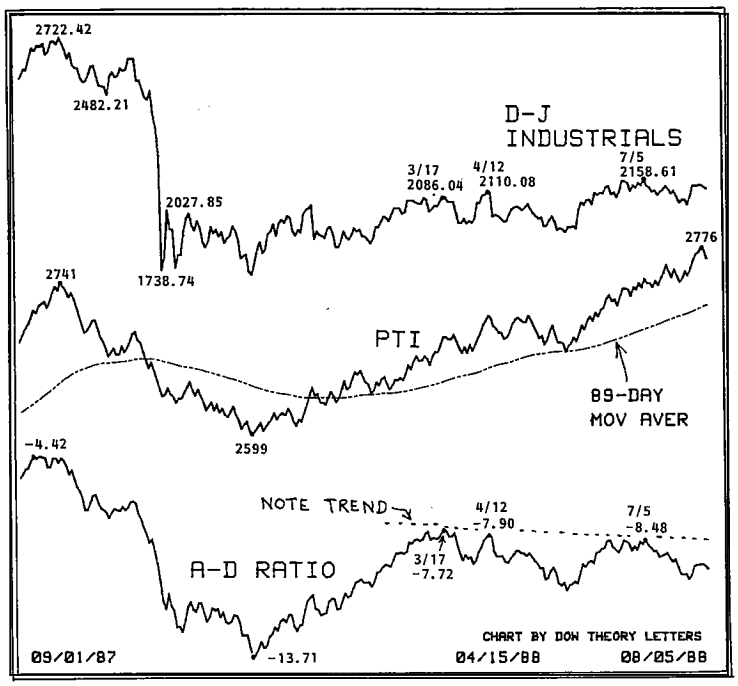


In this kind of erratic, rumor-driven atmosphere (and keeping in mind that it's a bear market), the best place to be is on the sidelines watching the show. Remember this: The pros get paid for handling other people's money and jerking the market around. You and I have to be more serious -- we're handling our own hard-earned money.

I've just finished reading two very popular advisory services. One of them monitors 52 different indicators, and out of this hodge-podge they somehow come up with a bearish opinion. The other monitors 37 different indicators, and by some hook or crook this service ends up bullish. I honestly like these two services, and I attempt to follow the logic in each of these reports. Frankly, I just end up confused.

For my part, I try to keep it simple. For that purpose, I concentrate on the Dow Theory. The Dow Theory, correctly interpreted, will, among other things, identify the direction of the great primary trend of the market. True, the Theory won't tell you whether the market is going up tomorrow or down next week. But those who expect the least of the Theory seem to get the most out of it, while those who demand perfection get little or nothing from Dow's Theory.

In interpreting the market, I need all the help I can get. For this reason, I follow the market with a number of additional devices, all based on the action of the market itself. Principally, I use the advance-decline ratio along with my two proprietary indices, the Primary Trend Index (PTI) and DowPow. The A-D ratio tracks the direction of the majority of NYSE stocks. The PTI tells us which side of the market to be on at any given time. And DowPow reveals the strength (or lack of strength) of the market on either the upside or the downside.

At this point, a short review is in order. From the standpont of the Dow Theory, a primary bear market has been in progress since August 1987. The bear market is in its first phase. This is the phase where stocks go down for no apparent reason. Furthermore, they go down in the face of still-good business, thus frustrating and confusing both the professionals and the public. The first phase of a bear market serves to wipe out the frenzy and froth which existed at the preceding bull market top.

As this is written, business is still good and the public is still in the market (they haven't sold their stocks although they've stopped buying). But in the face of all the rosy business news, the Dow, so far, has recouped less than half its August to October losses. Interest rates are slowly rising, and financial liquidity is contracting. Fed Funds are now higher than they were prior to the crash.

The A-D ratio recorded its high for the year on March 17. Thus, March 17 marked the high for the majority of NYSE stocks. Despite a continuously rallying Dow, the A-D traced out a lower peak on April 12 and a still lower peak on July 5 (see page 2 chart). This ominous divergence tells us that the majority of NYSE stocks are refusing to follow the Dow to new recovery highs -- and that, if history means anything, is a very bearish indication.

My PTI hit new highs last week, telling us that the technical undercurrent of this market is still positive. In the past when the Dow and the A-D stubbornly refused to follow the PTI to new highs, it was an indication of trouble. However, and this is important, real trouble will not materialize until the PTI turns decisively down.

DowPow remains stuck in the trading range which was illustrated in recent Letters. The incredibly sluggish action of DowPow tells us that the bear has subtly been in command all along. The real money is made in the market when DowPow moves up powerfully as it last did during 1984-87. To put it mildly, DowPow hasn't been doing much of anything during 1988. That pretty much describes the typical stock portfolio.

INVESTMENT POSITION: The bear is in the box. The good action in this market (and I have pointed to this for many months) has (surprise) been in BONDS. Last week the municipal bond contract broke out (upside) to a new multi-month high.

My investment advice ever since mid-1987 has been to be "out of stocks and into high-grade muni bonds and money market funds or T-bills or muni-cash funds." There's where I, personally, have been, that's what I've recommended to subscribers, that's what I still recommend. So far the policy has worked.

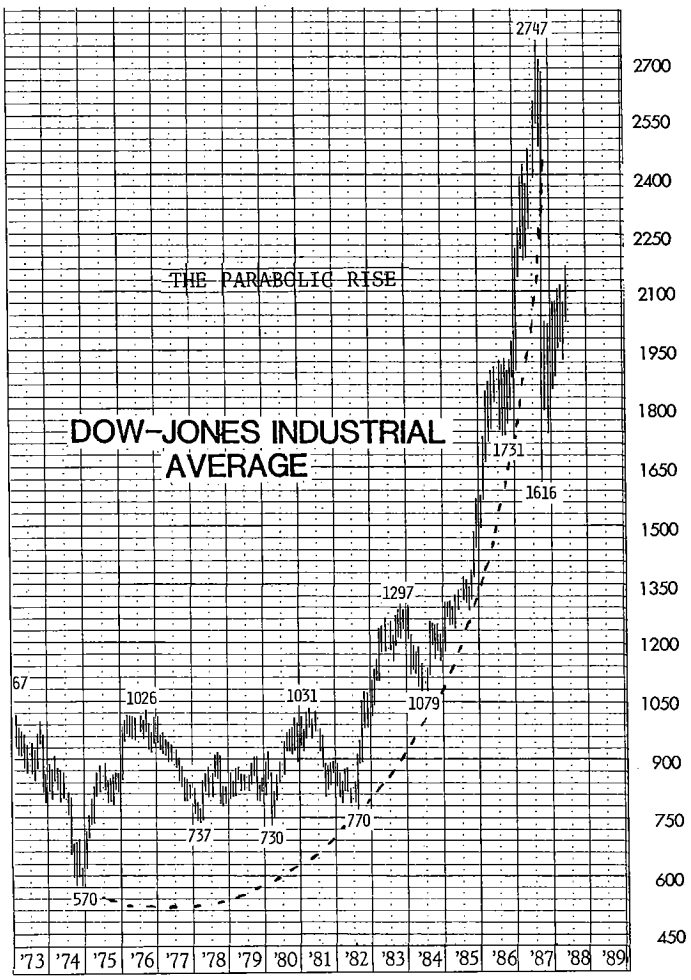
PARABOLA: With all the talk and debate about "is it or isn't it a bear market," subscribers may have forgotten one item I wrote about over and over during 1987. That item dealt with the parabolic (exponential) rise in the D-J Industrial Average, a rise that began in 1974 and continued until 1987.

I include an up-to-date chart of the 1974-88 action (chart courtesy of M.C. Horsey). What we see here is the parabolic rise, a rise that increased in velocity as the bull market matured. It is the nature of a parabolic rise to slowly gather upside steam, then rise faster and faster until, in its final stages, the parabola assumes an almost vertical ascent. Of course, such a vertical climb cannot be sustained, but the important consideration is this: When a parabola finally "blows itself out" on the upside, this is indicative of a **state of total exhaustion** as far as the given item is concerned.

When the last buyer has frantically spent his money, the parabola turns down. The downturn, as I explained repeatedly last year, is never calm, never pleasant. True to form, the 1974-87 parabola ended with history's greatest crash, a crash that lopped an incredible 508 points off the Dow in a single ghastly day. If there was any doubt about the parabola signifying exhaustion, if there was any doubt about a bear market having started, the action of October 19, 1987 should have ended it.

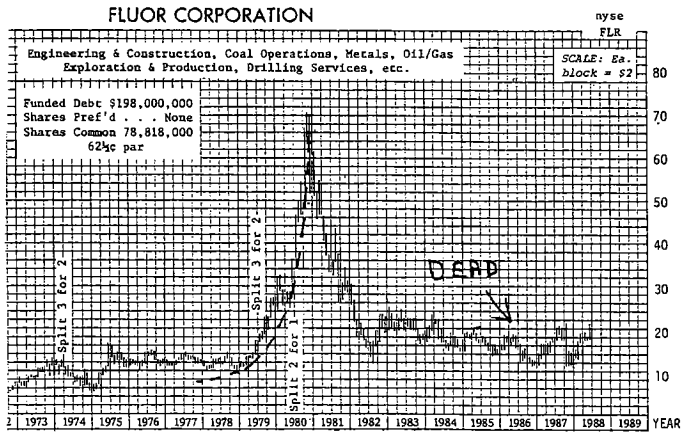
I have studied parabolic curves in the financial markets for years. One of the almost guaranteed characteristics of the parabola is that following the initial breakdown, there is a pullback which can be powerful in some instances and weak in other instances. After the pullback, the price action will continue on the downside again. In the vast majority of cases, once a parabola spikes up and collapses, it takes years before the price action turns long-term bullish again.

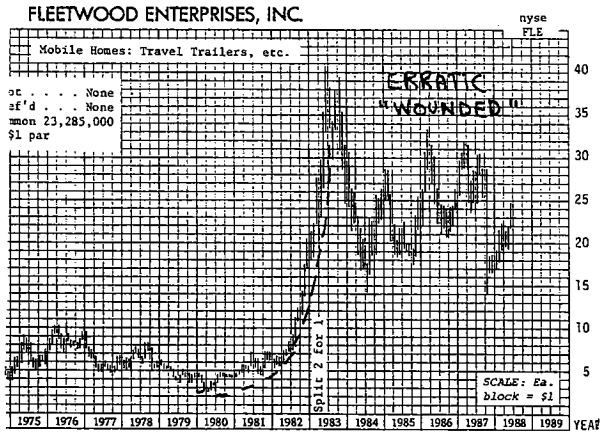
So my point here is that this bear market not only started from a condition of extreme overvaluation and tremendous investor enthusiasm, it also materialized out of a frenzied parabolic rise.

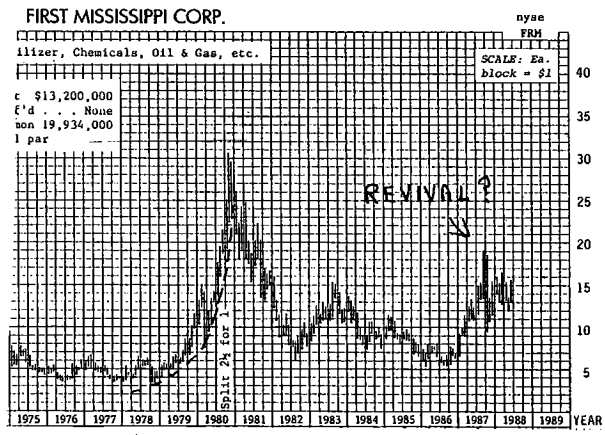


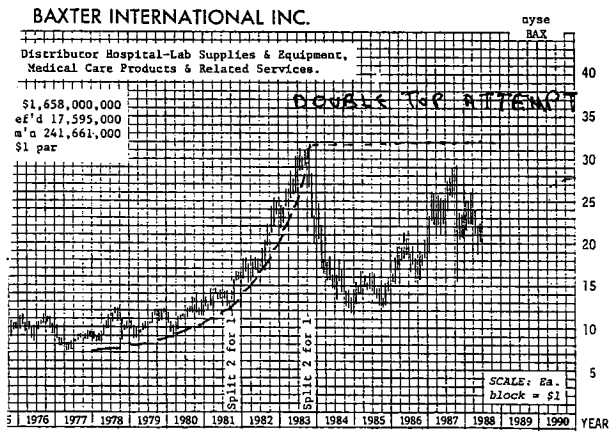
I am including a few Horsey (monthly) charts of individual stocks that hit peaks in parabolic rises. Note the differences in the action following the breakdown of these parabolas. Fluor went into a parabolic rise during '78 to '80. When the parabola "blew out" on the upside, FLR crashed back to its '78 level and then went dead. Fleetwood is a different story. When its '81 to '83 parabola ended at 41, the stock smashed down to 14, then rallied to an '86 high of 33. From there FLE crashed back to 14 again.

First Mississippi Corp. rose from 4 to 30 in a great parabolic rise. When the parabola ended, FRM sank to 6, rallied back to 15, then dropped to just over 5. The stock advanced to 19 in '86, but it's still "wounded" as you can see. Final example: Baxter Int. This stock went into a '79 to '83 parabola which ended at 31. BAX then sank to 12, double bottomed in '84 and '85, then rose to a near-double top in '87. But the oomph was out of the stock and most recently it dropped back to the low '20s.









It's worth noting that when the market crashed last October, dozens and dozens of stocks topped out of parabolas and smashed to the downside (examples: Coca Cola, Dow Chem, duPont, Raytheon, Bristol-Myers, Merck, Pfizer, General Mills, McGraw-Hill, Wal-Mart Stores, Philip Morris, Scott Paper, Ryder Systems, and on and on.

Conclusion: In the vast majority of cases, once a parabolic curve blows its top in a vertical climb, the item is finished for years to come. You can get impressive pullbacks, even an occasional double top, but seldom, very seldom do you get new highs. The mature parabolic rise is indicative of buyers' exhaustion with a bear market directly ahead.

MONEY: Norm Fosback of *Market Logic* (3471 N. Federal H'way, Ft. Lauderdale, FL. 33306) is a brilliant stock market student, and he puts out a fine report. Only problem is that we disagree on the main trend of the market. Norm is bullish, I'm not.

However, in a recent report Norm included an index which I follow closely. It's his discount rate to T-bill index (chart is at bottom of page 4). This Index traces the monetary intentions of the Fed. When the Fed wants to tighten short-term rates, it allows the T-bill rate to climb above the discount rate (the discount rate is the rate the Fed charges member banks for short-term loans). When the T-bill

rate is above the discount rate, there's pressure on the short-term money market.

Norm uses a 15-week moving average of the difference between the discount rate and the T-bill rate, so that it takes pretty steady action on the part of the Fed to move this index one way or the other. In July (see chart), this index turned negative, rendering a "bear signal" for the stock market (which obviously does not like money market pressures).

The record of this index is outstanding. Negative readings on the index caught the severe 1957 reaction, the 1966 bull market top, the 1969-79 smash, the 1973-74 bear market disaster, the 1981-82 slide, and again the 1984 decline. Note that the Index turned bearish in early-1987, well ahead of the October crash. Now the Index is bearish again. I guess that should suffice as a warning.

THE 200-DAY MOVING AVERAGE: A lot of nonsense is currently being written about the 200-day moving average of the Dow and its meaning when it turns up or down. Many commentators are saying that now the 200-day moving average has turned up, "it can't be a bear market because the 200-day MA never turns up in a bear market."

To which I must answer, "Pure bunk." Any rise in the market, if it lasts long enough, is going to turn the moving averages up. That doesn't tell you anything about the primary direction of the market. I just went back over the years. To give you an example, the 200-day MA turned down in 1957 during that vicious downside correction. Did that tell you that the bull market was over? Hardly. The correction ended in October 1957 and the great bull market resumed with a vengeance.

By the same token the recent upturn in the Dow's 200-day MA is no indication that the bear market has ended. I hate to disappoint the optimists, but it just isn't that easy to identify the direction of the primary trend. I wish it was!

MUGGED or "I Left My Wallet in San Francisco." We went up to San Franciso on the weekend of July 23-24. I was giving a speech to the Benham Capital Mangement group. I'm an early riser so around 5AM I left the Sheraton-Palace Hotel to see if I could dig up a *New York Times*. I headed up a side street off Market, and that was a major mistake. Two big guys of African-American persuasion trotted up behind me, and wham, I was belted. They took my wallet but, for some strange reason, overlooked a Rolex. A long habit of removing cash proved helpful, as I had only $3 in the wallet. Without checking the wallet, the bad guys ran off, jumped into a car about a block away, and zoomed off. I headed back to the hotel to tell wife Faye my sad story. That ended her Sunday morning sleep.

Four days later a kindly SF lawyer called me in San Diego to tell me that he had found some of my papers blowing along the street in the "tenderloin" district of SF. He mailed the papers to me. So I ended up with missing credit cards, a missing driver's license, no wallet, a black eye, and a determination to stay off Market Street in San Francisco at 5 in the morning. A few days later Howard Ruff called, and I told him what had happened. He related that he had been mugged (with a knife at his throat) in NYC so he "knew the feeling." It's a jungle out there, readers. Be careful in the big cities -- and the small ones.

NOTES & QUOTES: On July 28 Revco, the drug store giant (2,000 stores), filed for bankruptcy under Chapter 11. This is the largest of the leveraged buy-out companies to go belly-up so far. Revco failed to pay $46 million in interest owed to holders of its $400 million in junk bonds. Watch for more big junk-bond bankruptcies coming up; in my opinion this is only the beginning.

* *

Just as military prowess and endless wars dominated the 1960s, '70s and '80s, economics seem fated to dominate the late-'80s and '90s. Iran, Iraq, N. Korea, Russia, and the Communist satellites are looking at booming Japan, Hong Kong, Singapore, S. Korea, Thailand, Taiwan, and wondering what the military spending and endless wars are all about. Furthermore, the "warriors" are seeing themselves being left far behind in the struggle for a rising standard of living. Russell's prediction: A major drop in military spending worldwide. A major rush to build economic power. Coming: Unbelievably tough competition in a new world of high productivity and instant communication.

* *

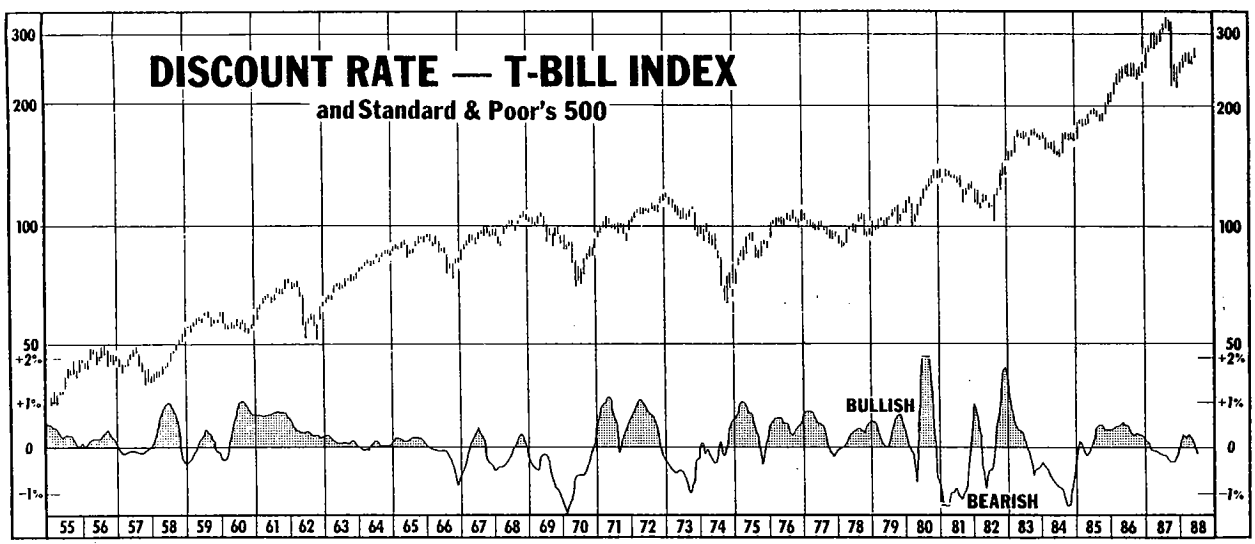
What's new in the so-called "battle of the wimp vs. the shrimp"? Here are two interesting items: Over the last 70 years, if interest rates rose during the year prior to the election, the incumbent president lost (Hint: rates rose last year). BUT, of 14 presidential elections since 1900, 12 were foretold by stock prices. If stocks advance between the close of the last Presidential convention (this year it's Aug. 18) and Election Day, bet on the incumbent (Bush). If stocks decline, bet on the challanger (thanks to *The Primary Trend* and *Smart Money* for these items).

* *

Everybody is tempted to boast once in a while, so here goes. I must be doing something right because I believe we have the highest subscription renewal rate in the industry. Here are our renewal rates so far in '88: Jan., 88% of expirations renewed; Feb., 90%; Mar., 82%; April, 81%; May, 94%; June, 85%, June, 85%; July, 86%. The advisory letter industry usually averages about 50% renewals.

* *

B-1 Bomber, a 30-year ongoing saga of politics and waste. Eisenhower believed future wars would be fought with missiles and was against the B-1. So the military went over his head and took the B-1 directly to Congress . The process was repeated with each dissenting president. The plane finally got built. Result: During 1982-88 an average of 40,000 workers were on the B-1 project. Half were from Rockwell, the rest were from several



thousand companies in 48 states. In the peak production year, 1985, 60,000 worked on the B-1. Does the B-1 work, can it be used in wars of the future, is it already an antique? According to a report issued last week by the Defense Dept., the B-1B "will accomplish about 50% in terms of the gross assessment of what it was supposed to do."

* *

The home-buying frenzy continues in California. During the month of June, average home prices in the state increased 4.6%, up an unbelievable 19.1% from June last year. Many home buyers are deciding that it's too difficult or expensive to trade up, so they are simply adding on to their existing home. Thus, there is a drop in the number of homes listed for sale.

* *

Africa: When I was a kid they used to call Africa "the Dark Continent." Things haven't changed. This is from a July 24 *NY Times* book review: "Africa's total external debt is now $135 billion. In some countries upward of 40% of the civilian and military leaders have AIDS. The continent, which fed itself in 1960, now must import two-fifths of its food. And as the food supply shrinks, Africa's population growth rate today -- 3.2% -- is the highest seen anywhere, anytime, throughout history."

* *

Shoplifting is becoming the great American pastime. This year roughly 2 million Americans will be charged with what they call "the five-finger discount." It is estimated that for every arrest, 25 other shoplifters get away with it. Most shoplifters are between the ages of 25 and 45, and more of them are women than men. The cost of goods stolen is thought to be as high as $50 billion a year. The stores of choice -- supermarkets. Average cost of groceries per "grab," is $11 while average department store theft is $100. Supermarket thefts are usually for high-quality items. Theory: "You might as well get busted for a pound of steak as a pound of hamburger." Psychologists believe the thefts are symbolic of a real need for love, affection or sex. The shoplifter is saying in effect, "If you won't give it to me, I'll get it somewhere else, even if I have to steal it."

* *

Classic cars are hot, and owning a 1950s American car in Japan is a major status symbol (Japan wasn't exporting cars in the '50s). Current hot cars: big-block Corvettes circa mid-'60s, 12-cylinder E type Jags circa early '70s. With the new Lucas/Coppola film on the life of Preston Tucker ("the Car of Tomorrow Today"), the Tucker cars are currently red hot. Only 57 were produced, 46 still exist, and the price runs $80,000 to $100,000 if you can find a seller. *Motor Trend* (Sept. 88) checked out the top end speed on 10 of today's hot cars. Winners: Ferrari Testarossa, top speed 175; Porsche 928S 4 at 165; Chevrolet Corvette at 156; Nissan 300 ZX Turbo at 153, and the BMW M6 at 149. Top speed recommended for subscribers: 55 mph.

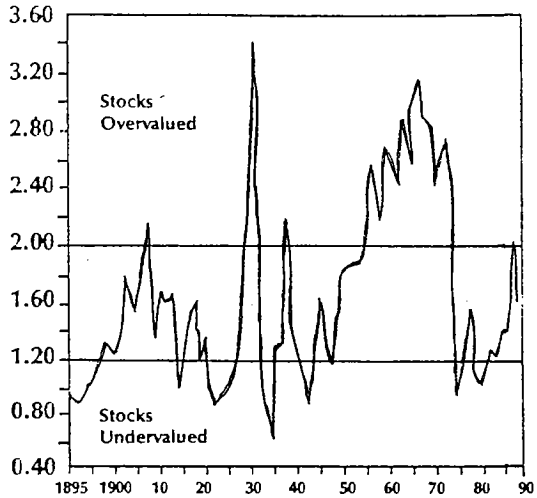
* *

Labor: On a cold appraisal, US unions are on their deathbed. In 1960 almost a third of American workers belonged to unions. By 1986 the percentage had dropped to 17.5%. Since 1984 union workers have been getting lower raises than non-union workers and strikes have dropped drastically. . . . Women are swarming into the labor market and today make up 44% of the work force. Women-owned businesses are the fastest-growing segment of small business.

* *

Here's an interesting chart from the book, "Panic-Proof Investing" ($18.95, 191 N. Hartz Ave., Suite 6, Danville, CA 94526). What we see here is a very long-term chart of the S&P 500 divided by the dollar price of an average house. This is a relative strength chart, showing the relationship between stocks and homes. As such, the chart doesn't show you when stocks or homes are overpriced or bargains, but it does show you when stock are expensive or cheap compared with homes, or vice versa.

As you can see, stocks were cheap compared with homes in the late 1800s, in the early 1920s, in the mid-1930s, during 1973-74, and most recently around 1980. Conversely, houses were cheap compared with stocks during the late-1920s, during 1936, and during the whole period of 1955 to around 1970.



Right now neither stocks nor houses are overpriced or bargains in relation to each other. But my guess is that the ratio is going to move down to an area where stocks are again cheap compared with houses. In other words, for whatever reason, home prices are liable to hold up better than stocks in the bear market that lies ahead.

* *

Isn't the devalued dollar the answer to all our troubles? Sure, if you look at our exports alone. But then there's this other thing, which we can call "selling the store in order to carry the debts." This piece is from the July 28 *USA Today*:

Foreign interests are gobbling up USA properties and investments faster than ever.

A study released Wednesday says foreigners' holdings have tripled since 1980 to reach $1.5 trillion. Foreigners now own:

▶ 20 percent of prime commercial real estate in New York City, including all or part of the Tiffany building and the Exxon building.

Among other foreign-owned landmarks: Washington's Watergate complex, the building housing the Department of Justice; Arco Plaza in Los Angeles.

▶ 10 percent of our manufacturing base, including most of the consumer electronics and concrete industries. Foreign-owned plants account for 7 percent of our manufacturing employment.

▶ 12.5 million acres of farmland in 49 states.

▶ $1.3 trillion in investments in government securities, banks and stocks; $262 billion in direct investments, such as manufacturing plants and real estate.

Led by the Japanese, foreigners have gained a big presence in our banking system.

More than 25 percent of our commercial and industrial loans are owed to foreign banks. Foreign investors hold about 20 percent of all bank assets in the USA, 33 percent of which are in Los Angeles.

In 1987, foreigners bought 306 companies here for $25.6 billion — a figure expected to jump 50 percent in 1988.

* *

Le Difference: This from a subscriber who recently moved from California to Texas: "I've been working for several months here in Austin, Texas. What a difference from California! People here understand the meaning of work. Everybody I've met puts in 40 hours of real work, worries about company profits, and Friday's quitting time is 5PM as usual (no drifiting off early for happy hour). It's amazing what a hard recession can do to realign attitudes."

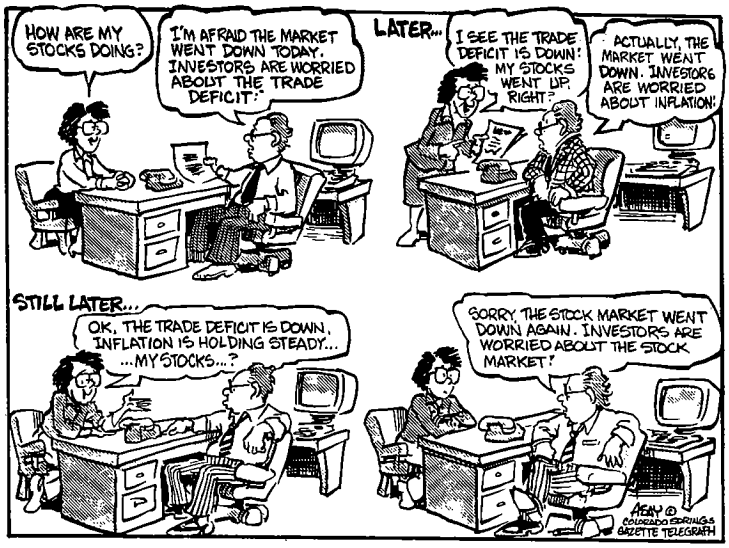
* *

Another subscriber, Dr. W.M. Patterson, has done extensive research on longevity and he uses the US presidents (who always get the finest medical care) as examples. The first five presidents lived an average of 79.6 years (if we omit Washington 82.2 years). The last five lived (omitting Kennedy) an average of 74.5 years. To put it differently, the first ten presidents lived an average of 77.2 years while the remaining 22 (omitting assassinations) lived an average of 68 years. Writes the doctor, "To put up a feeble defense for the medical profession, I must point out that the four presidents who are still alive are doing quite well, thank you, and their ages so far average 70.6 years. They will, however, have to live a combined total of 46.4 years to equal the record set by the first

four, and I'm not going to put a lot of money on that possibility. . . . Trivia: One president was born on July 4 and three died on that date. No one born in June has ever been president and no president has ever died during the month of May."

* *

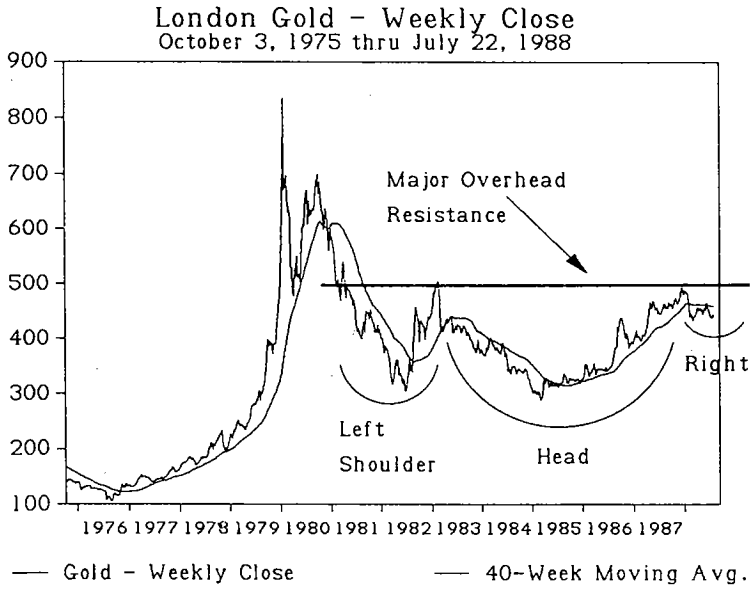
This cartoon may be the best commentary on the '87 market yet. Could the cartoonist have inside information?


HOW ARE MY STOCKS DOING?
I'M AFRAID THE MARKET WENT DOWN TODAY. INVESTORS ARE WORRIED ABOUT THE TRADE DEFICIT.
LATER...
I SEE THE TRADE DEFICIT IS DOWN! MY STOCKS WENT UP, RIGHT?
ACTUALLY, THE MARKET WENT DOWN. INVESTORS ARE WORRIED ABOUT INFLATION!
STILL LATER...
OK, THE TRADE DEFICIT IS DOWN, INFLATION IS HOLDING STEADY... ...MY STOCKS...?
SORRY, THE STOCK MARKET WENT DOWN AGAIN. INVESTORS ARE WORRIED ABOUT THE STOCK MARKET!
AEIRY © COLORADO SPRINGS GAZETTE TELEGRAPH

* *

Aside from Jesse Jackson, the 1988 Presidential campaign has been a bit or a bore so far. But one thing is clear. George Bush is behind everywhere but the South. Which gives rise to a fascinating rumor: Bush may be preparing a bombshell surprise on or around August 18. The surprise would be one of the following three as his VP candidate: baseball commisioner Peter Ueberroth, actor Clint Eastwood or Chrysler Chairman Lee Iacocca. As someone once said, "I hate to repeat rumors and gossip -- but what else can you do with them?"

GOLD: The South African Krugerrand is avoided by many US gold buyers because of the stigma of S. Africa. But relax, Kruggies are brought into the US no longer, so if you buy Kruggies you are simply buying them from another American. Furthermore, the Krugerrands are invariably the coin with the lowest premium over actual gold content. Therefore, from the standpoint of buying gold "on the cheap," the Kruggie is the best buy.



Canada has now moved into the lead as the world's #1 seller of gold coins, Canada now boasting 55% of all sales. The US is #2 with its Eagle now taking 30% of sales. Canada is hoping that it's success with gold will rub off on platinum, and the Canadians are about to issue a platinum Maple Leaf in sizes of one ounce, half ounce, quarter ounce and tenth ounce. The platinum for the new coins may have to be imported from Russia, since the other major platinum producer is S. Africa, a nation which Canada embargoes. So far, as you might expect, Japan has been the big buyer of platinum coins. Last year the Japanese bought 745,000 ounces of platinum in the form of jewelry and coins.

Is it possible that gold is in a massive basing pattern? This chart, published by *Gold & Money*, PO Box 4634, Greenwich, CT 06830, suggests that it is. Their chart shows gold in a massive head-and-shoulders bottom, with the metal now in the process of forming a right shoulder.

Personally, I'm a bit skeptical of the head and shoulders interpretation, mainly because it is doubtful whether a H & S taking eight years to form is valid. Most head and shoulders patterns are formed during a period of a few weeks to perhaps three or four months. Over an eight year period fundamentals can change drastically, and Edwards & Magee (authors of the famous "Technical Analysis of Stock Trends") did not believe that H & S patterns extending over a year or more were valid.

However, I will say that the formation does look promising for gold. The latest plunge (i.e., the right shoulder) has not taken gold nearly as far down as did the 1982 or early-1985 drops and there seems to be massive support at above 400 for gold.

The major overhead resistance for gold comes in at the 500-520 area. And it would not surprise me to see gold above the resistance some time during the next year. In the meantime, I feel that gold is in a low-risk accumulation area, and I keep buying those coins on the first of every month.

LATE NOTES: The state of California is coming out with $3 billion of tax anticipation notes, due next June and free from state and federal taxes. The original yield on these very safe, short-term notes was to be 5.75. Then I got a call last week saying that the notes were not moving too well, and the yield would be nearer 5.95% to 6%. With the Dow yielding a taxable 3.6%, you can see why investors are getting a bit nervous about buying stocks.

Remember this: the primary trend is set by the big money, the informed money, the money that knows values. "To know values," wrote Charles Dow, "is to know the meaning of the market."

So the action in this bear market is confined to the mergers and acquisition items and the utility dividend retrieval operations. As far as real investment buying, there's little or none of it. The astute investors who distributed stocks all during 1987 when average stock yields fell below 3% are hardly coming back to the market today when average stock yields are only 3.5%. No, they'll wait for the great values, the bargains that will appear at the ultimate bear market bottom. That's how the truly astute investors make money. They know values, and they have patience, patience and more patience. Of course, it's easy to be patient when you're getting 6% and more on tax-free short-term money.

Since March, when the advance-decline ratio topped out, the stock market has gone nowhere -- and time is slowly running out for the recovery. The bear is patient, too. The bear's in command, and he will appear when his arrival is least convenient for the greatest number of players.

Final Thought: The Fed's dilemma is intensifying. The Fed wants to hold the dollar steady as per the G-7 agreement, but inflation is heating up along with the current heat in the US economy. This should call for higher interest rates. Higher rates make for (1) a stronger dollar and (2) big problems for Mr. Bush as we move into election time.

NEXT MAILING: Aug. 24